Restaurant Business

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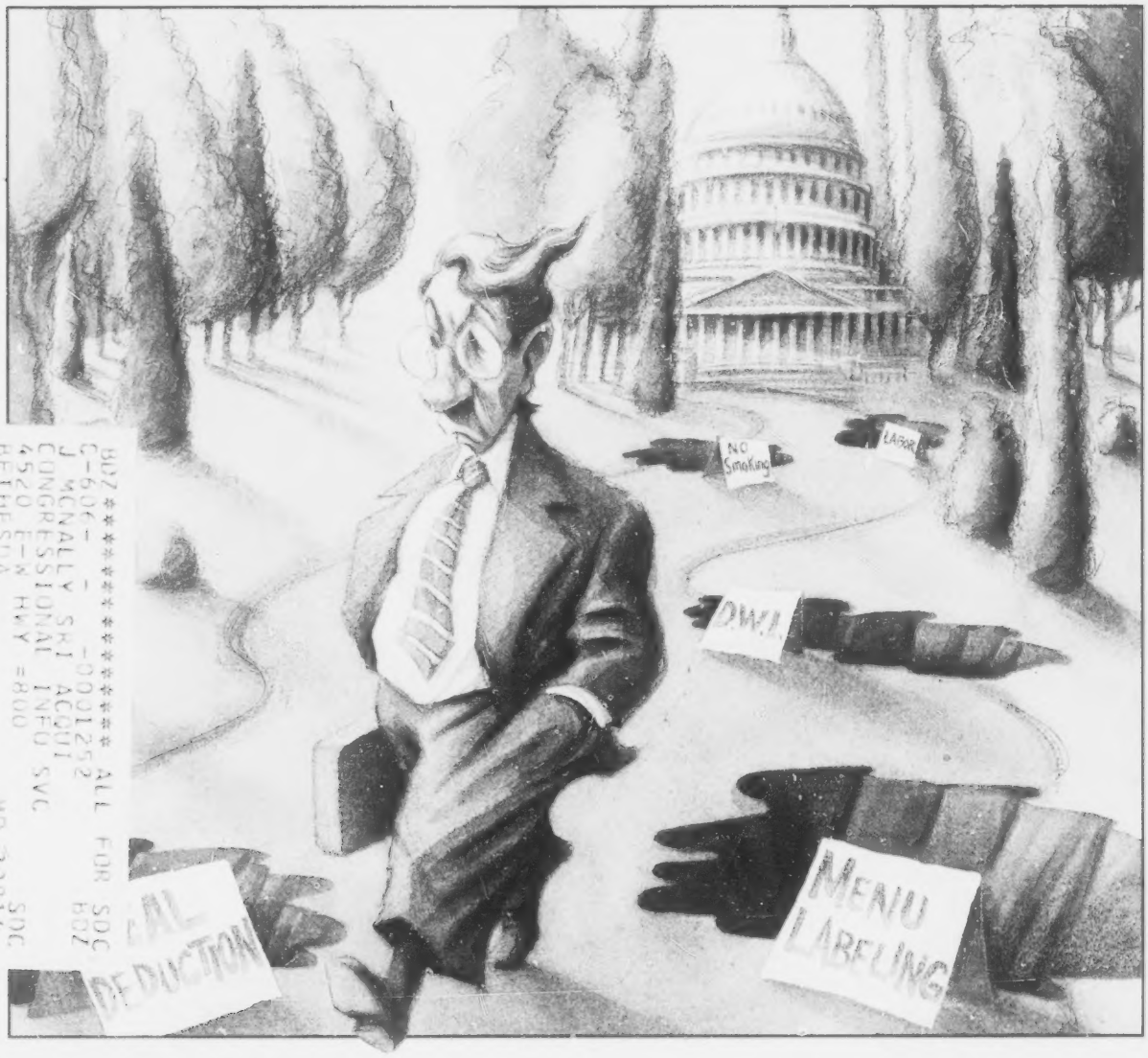

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Cover illustration by Brian Ajhar.

THE BREAKFAST SEGMENT

by Ralph Raffio

Breakfast is booming, creating challenges for the entire industry. Convenience stores and fast food chains are squeezing family restaurants for a.m. business, and hotels no longer take breakfast for granted.

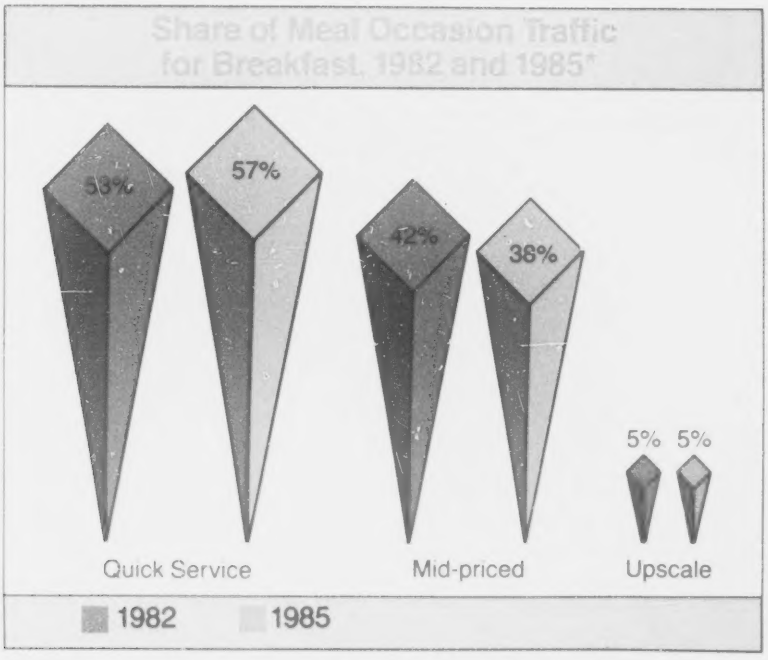
Breakfast is the fastest growing market, according to CREST, and it increased by 20 percent last year.

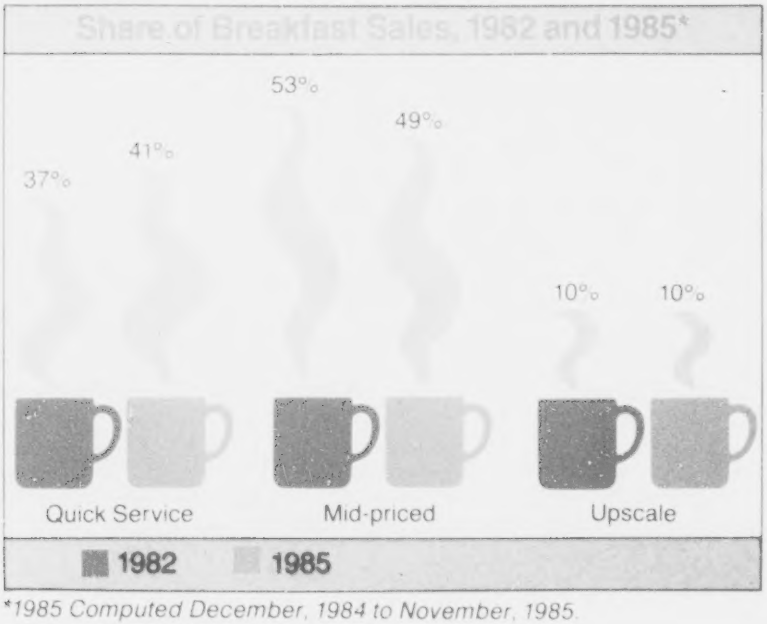
Breakfast has become a gruelingly competitive meal period. Although the morning meal pie has grown much larger in the past few years—both in dollars spent away from home and in the number of customers dining out—so has the number of operators competing for those sales. In most cases that's been good for operators, and for the industry. But not always.

The emergence of the fast food restaurant chains in the breakfast segment has offered both positive and negative effects. From the time Oak Brook, IL-based McDonald's Corp. rolled out the Egg McMuffin nearly 10 years ago, the away-from-home breakfast market has exploded beyond most expectations. A new customer was created by McDonald's then bold move, one who wants breakfast in a hurry—if at all. Opportunity knocked and the chains have been happy to oblige with quick-to-eat, hand-held breakfast items—finger foods suitable for consumption almost anywhere.

On the downside, the traditional breakfast outlet which never had to be very fast to be good has found itself confronted with having to compete with the marketing muscle of the chains. And, although there is scant numerical evidence that mid-price, family restaurants and coffee shops have been hurt by fast food's breakfast ascendence, many foodservice industry onlookers believe they have. Furthermore, recent developments in the mid-price sector—including bolstered dinner programs among many chains—support those beliefs.

"There's no question that the fast food chains have made it harder for the coffee shop chains to compete," says Charles Glovsky, senior securities analyst for Alex. Brown & Sons.





*1985 Computed December, 1984 to November, 1985.
Source: The CREST Household Report

Fast food chains depend on finger foods and take-out for dominance.

Roy Rogers first tried breakfast with its crescent sandwich menu item.

Baltimore. "It's forced them (coffee shops) to focus more on other dayparts."

Mid-price chains like La Mirada, CA-based Denny's Inc. are indeed concentrating efforts on other meal periods. Though most are hard-pressed to link such moves to the fast food chains' breakfast push, one thing remains clear: The mid-price morning market isn't growing nearly as quickly as the fast food chains. Denny's, the largest mid-price chain, is a good example: Breakfast has accounted for 20 percent of total sales each year since 1980.

It's difficult to judge just how big a business breakfast has become, but some available figures definitely disclose a trend. Total eating place sales in 1985 were $111.5 billion, according to the National Restaurant Association (NRA). Of that, 6.7 percent went to breakfast, says Park Ridge, IL-based GDR/CREST Enterprises, a marketing and consulting firm. That means about $7.5 billion was spent on breakfast away from home last year, and that's just in eating place sales. Those figures do not include restaurants serving liquor, institutional foodservice, or employee cafeterias, many of which also serve breakfast.

According to CREST, the total breakfast market increased by 20 percent in 1985, compared to an eight percent total increase for the industry over 1984. In breakfast sales and traffic, fast food has shown solid gains in each of the past three years. Though mid-price restaurants still rally 49 percent of breakfast's total sales, that represents a decline from a 53 percent share in 1982. In the same time period, fast food has gone from 37 percent to 41 percent of total breakfast sales.

Traffic during the morning meal period showed similar results. Fast food went from a 53 percent to a 57 percent share of breakfast traffic, while mid-price declined from 42 percent to 38 percent.

All of which is to say that while fast food has created new customers, there are still different factions coexisting under the breakfast umbrella. Fast food caters to one, mid-price to another, and hotels and other restaurants to yet another. And that same customer seeks different choices at various times of the week. "What the customer looks for during the week is different from what he looks for on weekends," says Miami-based Burger King Corp.'s vice president menu development, Jack Winkler. "The bulk of our breakfast business is done during the week, and platter consumption increases on the weekend."

Fast food restaurants depend heavily on hand-held, easily portable items and take-out sales, while most other types of restaurants provide a different kind of experience and value.

"Realistically, if someone wants to go to a drive-thru, they're not going to come to us," says Roger Williams, vice president of marketing for Colombus, OH-based Bob Evans Farms Inc. "But if I'm going to meet someone for breakfast, I'm going to either meet them in a hotel or a restaurant like ours."

Like other family restaurants, Bob Evans sells a lot of breakfast items. But it also has moved aggressively toward dinner business. "As a percent of sales, we've been trying to reduce the dependence on breakfast," explains Williams. Dinner now accounts for 43 percent of the chain's total sales, which is "substantially up" over previous years, according to Williams. Though the chain's breakfast program remained unaltered last year, selective advertising of weekday specials was stressed.

To family restaurants like Bob Evans, breakfast is old hat. But that's not the case at all with most fast food chains. As a meal period, breakfast is still new to most of them, with the exception of McDonald's.

Though the company will not divulge sales figures, industry watchers place McDonald's breakfast program at accounting for just under 20

The Croisan'wich is Burger King's morning mainstay.

Circle K competes heavily in the daypart with breakfast sandwiches.

percent of the chain's total sales. With average unit volumes at about $1.3 million annually, that means breakfast accounts for just under $250,000 in sales per restaurant before 11 a.m.

McDonald's refutes industry reports that it will roll out its sausage biscuit program this spring. The company is expected to do so after successful widespread testing of the product in 1985. McDonald's onlookers say the sausage biscuit will effectively replace its Sausage McMuffin, which will then only be available with sausage and egg. McDonald's denies those reports, however.

Anticipating the sausage biscuit rollout, New York-based Prudential-Bache Securities Inc.'s senior restaurant analyst Michael Culp says the chain will heavily support the move. "We'll see McDonald's push harder in the spring," claims Culp. "They will market it aggressively."

Having taken an early lead in fast food breakfast, McDonald's program is by far the most successful. Though that hasn't stopped others from moving ahead with their own campaigns, it has made it more difficult for those just getting in. The overall fast food market is so fiercely competitive that one can hardly avoid adding a program consumers have widely demonstrated they want. Most chains have recognized that neglecting breakfast could give the competition an edge, even during lunch and dinner.

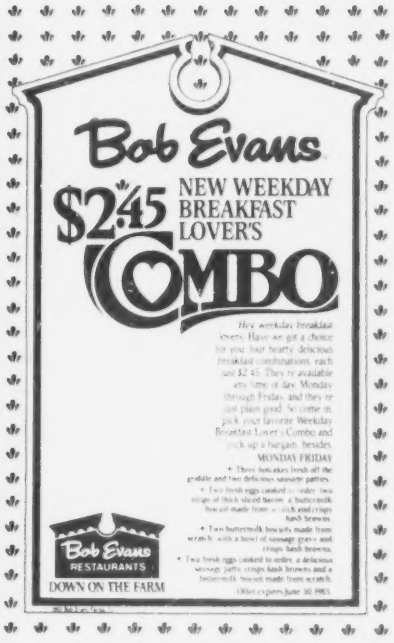
"Operators who do not go into breakfast will clearly be at a disadvantage," according to Glovsky of Alex. Brown. "Fast food operators cannot afford to have their customers go into somebody else's restaurant because they aren't offering a program of their own," he continues.

Fast food chains are feeling heat at breakfast from the convenience segment.

Late entries into breakfast have another problem, though. Gearing up for a rollout now is extremely costly, and has a good chance of hurting earnings—at least in the short term. "The marginal profitability of the next competitor entering breakfast is much less than that of the one who got in before him," says Glovsky.

Clearly that was the case when Wendy's rolled out its breakfast program last summer. The last of the "Big Three" to roll out breakfast, Wendy's results have so far been disappointing. Breakfast has been a drain on earnings, and sales before 11 a.m. just haven't rallied.

Wendy's dilemma is a crucial one for the company. Though it will report record sales and earnings again this year, the figures will be lower than previously expected. Industry observers say the chain's tardy entry in the breakfast market has been a factor, and some add that the program wasn't up to snuff. Wendy's breakfast is built around made-to-order omelettes and French toast, and had been tested for almost five years before rollout. The chain has been criticized for being characteristically adventurous to the point of displaying poor judgment in its final menu selection, and for not living up to operational standards, particularly regarding serving time. Says one



Although Bob Evans' breakfast sales are healthy, the company is trying harder to promote itself.

industry expert: "Wendy's problem is that it isn't offering a fast food breakfast."

Wendy's vice president for corporate communications, Denny Lynch, sees it differently. The company expected breakfast to affect earnings negatively at the outset, he says. It also didn't expect the daypart to be an instant success.

"We were figuring on a year, maybe longer, for the program to take off," says Lynch. "We knew that short-term, breakfast wouldn't be a large money-maker, but that long-term it's the place to be."

Wendy's, like other fast food chains, is committed to making breakfast a profitable daypart, and industry onlookers believe it eventually will. However, in order to do that, most believe the chain must change its program.

Some speculate that Wendy's must abandon its omelettes and French toast and steer toward handheld items like its competitors. Wendy's has a breakfast sandwich on the menu already—egg on whole wheat toast—though it hasn't initially been considered central to the program. Lynch says it is too early to say what Wendy's strategy will be in the long term, but does reveal that sandwiches and omelettes are best sellers. He says the company is now actively looking at menu alterations, but stops short of speaking negatively of existing items.

Cannibalization of other dayparts may also be a problem for Wendy's, but that's not unusual under the circumstances. "Whenever you introduce a new item there's some cannibalization, especially when it's a new daypart," says Glovsky. "But it doesn't appear that the degree of cannibalization at Burger King and McDonald's was as great as with Wendy's."

Burger King didn't roll out its breakfast program much before Wendy's, but it has met greater success. Burger King's Winkler says breakfast sales for the chain go as high as 14 percent of total sales, though analysts estimate a 10 percent mix systemwide is more representative, or about $100,000 in sales per unit annually.

The number two burger chain is looking to expand its menu, though. While the Croissan'wich remains

Many family restaurants are trying to reduce dependence on breakfast by pushing dinner.

the mainstay of Burger King's breakfast program, ongoing testing of new products stresses finger foods.

New products, including "Egglets," "French Toasters," and a meatless Croissan'wich are now being offered in five test markets.

Egglets come in three varieties: cheese, egg and ham sticks; cheese, egg and sausage sticks; and Western sticks. They come five pieces to a box and sell for 99 cents. French Toasters come four to a box, include syrup for dipping, and also sell for 99 cents.

The new items were designed for "ease of eating, and eating on the go," says Winkler, and are being "heavily supported" by advertising in test markets. "Our research strongly suggested the need for portability," Winkler adds, referring to the chain's decision to attempt finger food-type breakfast items.

Every foodservice operator must reckon with the fact that together McDonald's, Burger King and Wendy's will spend about $750 million on advertising this year. That's hard enough for other chains to deal with, but when trying to pull together a whole new daypart the huge chains' marketing muscle is staggering.

"Those sort of expenditures easily give the big guys an edge," admits Thomas Y. Whitley, vice president, marketing, for Atlanta-based Arby's Inc. "The question is, with the rapid addition of the giants, will there be enough growth in occasion to absorb all those new restaurants in the mix? In the short-term, probably not, but in the long-term it probably will."

Whitley projects a short-term shakeout of smaller chains and regionals, "those who don't have a commitment to the strategy."

Arby's began serving breakfast two years ago, at one point moving its sales mix to around nine percent the first year. But sales started to slide the second year. "That was a marketing-related problem," Whitley explains. "We've got a moderate share of voice compared to the giants."

Arby's doesn't plan to have a national breakfast program, but does expect to achieve a 10 percent sales mix from breakfast. Currently, the morning meal period accounts for under six percent of sales, with only about 900 of the chain's 1,545 restaurants offering breakfast. Units with breakfast will increase gradually, but they'll be mostly new restaurants. "We've located our restaurants over the years on the 'going home' side of the road, and we're not in many urban locations," says Whitley. "That's not convenient for morning sales."

Arby's, which also features a croissant in its program, extended its breakfast last year to include "French Toastix," a finger food item; a cinammon danish; and breakfast platters with eggs, muffin, and potato. These products have slightly higher profit margins than Arby's croissant sandwiches, and lower food costs. The new items were introduced last spring, and have achieved a 40 percent breakfast mix, says Whitley.

Another chain whose marketing clout is left wanting in the face of the giants is Bethesda, MD-based Marriott Corp.'s Roy Rogers Restaurants. "The breakfast market has to be supported by advertising, and we haven't been supporting ours as steadily as some others may have," says Roy Rogers spokesman Mary Maguire. Marriott does not plan a marketing push for the chain's breakfast program. Instead, the chain's signature products of roast beef, hamburgers and chicken will get the support.

Only 180 of Roy Rogers' 550 restaurants offer breakfast since the chain discontinued its breakfast bar test in December. To replace the all-you-can-eat breakfast buffet, the "Hearty Platter" was introduced last year. A platter of scrambled eggs, hash browns, biscuits, and breakfast meats, the item acts as an alternative to Roy Rogers' crescent sandwich.

As if competition for breakfast's on-the-go customer wasn't hot enough, convenience stores also want in. Coffee and donuts have always been respectable drawing cards

Although most fast food execs realize the need for breakfast, the entry price can be high.

Many operators are finding that variety and quality are important breakfast attributes.

for the more than 60,000 convenience stores around the country, but that market is about to take an interesting turn.

"Fast food has been on the bottom end pushing the middle, but now they're getting pushed by convenience stores," says Denny's David Bixler.

Recently, Denny's Winchell's Donuts division announced an agreement with the Atlantic Richfield Co. (ARCO) of Los Angeles to sell its donuts in 150 of the company's AM/PM markets, and Winchell's hopes to gain access to an additional 100 stores down the road.

Though convenience stores have historically kept a narrow focus on food, that's changed over the years as more of them have added fast food items like fried chicken to their stores. Now some are looking at breakfast anew.

Phoenix-based Circle K Corp. has decided to broaden its breakfast items with an eye toward competing with fast food. The 3,350-unit chain recently added two new breakfast sandwiches priced at $1.39. According to Steve Schwitalla, senior vice president of the foodservice division of Circle K, the new sandwiches are the best selling food items ever introduced. "That may not be significant if you're McDonald's, but for us it's important," says Schwitalla. "We're tapping into the daypart in a big way."

About $125 million, or about 10 percent of Circle K's total sales volume, is generated by fast food, but only 2.5 percent of that is breakfast items. That's hardly cause for concern among most fast food chains, but if the industry decides to commit to further penetration of the breakfast market things could easily change.

"Breakfast is a location-driven segment," says Arby's Whitley. "Convenience stores have done quite well at breakfast for years. I think you'll see them doing even more."

One industry segment that's been through it all, however, is hotel foodservice. And that has changed markedly as the importance of the morning meal has grown.

"Hotels in the past have taken the customer for granted where breakfast is concerned," says Karl Kilburg, vice president, food and beverage, Marriott Hotels. They've done that, he says, "by pricing too aggressively with the attitude that they've got a captive audience."

Kilburg says that's no longer the case with the fast food chains entering the market, and that the key now is to provide breakfast speedily and give the customer a good value. All-you-can-eat buffets have been hotels' answer to both these concerns; all Marriott hotels offer buffets on weekdays. "Buffets are a good value, and give give hotels a competitive edge," says Kilburg.

Kilburg adds that pricing will be a key factor among hotels, especially now that competition for breakfast business is tougher. "I don't think the industry will take breakfast price increases for a long time," he says. "Perhaps we'll even see slight decreases."

Upscale breakfast menus are gaining, however. At Hilton International Co.'s Vista Hotel in New York, "power breakfast" is stressed in a big way. Referring to morning business meetings over breakfast, the power breakfast has become an alternative to lunch meetings and an addition to those on a tight schedule.

New York's Vista also offers a breakfast buffet, although to meet its customers' demands for lighter foods, buffets offer juices, fresh fruits, and cereals instead of eggs and meats. For executives who are really in a hurry, Vista even offers a buffet in the lobby. It's easily acces-

About 80 percent of Le Peep's sales are generated by breakfast.

'Power breakfast' is emphasized at NYC's Vista Hotel.

Hotels have been working with buffets to take advantage of built-in demand at breakfast.

sible from the street, but mostly it's quick.

In the newly renovated Beverly Pavillion Hotel in Beverly Hills, CA, chef Patrick Healy targets the business client in a big way. The hotel restaurant, Colette, is formal in appearance and high-brow in its menu. Healy serves unusual items like "Painter's Palette," intended to lure patrons for breakfast. The giant-sized pancake is prepared with several sections cut out which are then filled with various fruit fillings, and sold for $4.75. "Poached Eggs Pavillion" features artichoke hearts with Canadian bacon. Served with a parsley hollandaise sauce, the item sells for $6.75. Healy's signature breakfast item, a homemade almond muffin, gets favorable reviews—and garners big profits—priced at $2.

Hotels aren't the only ones to target the business client. In San Francisco's financial district, Spectrum Foods Inc. recently added breakfast at its MacArthur Park restaurant. Known for its oakwood-smoked baby back ribs, MacArthur Park may seem like an unlikely spot for breakfast but Spectrum doesn't think so, especially for this location. Breakfast items include black walnut waffles, warm fruit compote, and red flannel hash, among others. Also offered are meats smoked on-premise, freshly baked breads, freshly squeezed juices, and real maple syrup.

There are still other opportunities in the morning meal period, witnessed by Denver-based Le Peep International's bold attempt at operating restaurants only between the hours of 6:30 a.m. and 2 p.m. Eighty percent of Le Peep's sales are through breakfast items, with 40 to 50 percent of business brought in on the weekends, Bernstein says. The menu includes some 40 egg, pancake and sandwich items including Awesome omelets ranging in price from $4 to $5.50; Pampered eggs from $4.50 to $4.95; and frittatas from $5.25 to $5.75. The average check runs $5.50, Bernstein says.

"Breakfast doesn't have to be humdrum and boring," says Le Peep founder, Allen J. Bernstein. "It can be sexy." Two-year-old, 14-unit Le Peep boasts unit volumes averaging $700,000.

Bernstein says his concept doesn't necessarily compete with other restaurants serving breakfast. "Pulling business away from somebody else is what Burger King and McDonald's do," he explains.

"There's not a lot of creation of new customers in the breakfast segment," says Bernstein, who claims that Le Peep has addressed a "sublimated demand." "Before we created this, where could a person go in this country for an upscale meal before noon?," Bernstein asks. A hypothetical question, but his words may be prophetic: If breakfast continues to grow, there are likely to be a lot more places to do that in the future. □